BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.

U.S. - U.K. ALLIANCE CASE	)	**Docket OST-2001-11029**

REPLY OF DELTA AIR LINES, INC.

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Delta Air Lines, Inc., ("Delta") hereby submits these reply comments in the captioned proceeding. The filings of the commenting carriers and civic parties bear little need for further elaboration at this point. Delta's reply comments will therefore focus on the important new competition analysis provided by the Department of Justice ("DOJ"). The DOJ's comments confirm what Delta and other carriers have been telling the Department all along:

- "the AA/BA transaction threatens a substantial loss of competition and higher prices for large numbers of consumers." DOJ at 3.
- London Heathrow and London Gatwick are separate relevant markets. "The evidence shows that premium passengers overwhelmingly go to LHR and that most attempts to compete with LHR service from LGW have been unsuccessful." DOJ at 20.
- "Entry into Heathrow Airport remains severely constrained. . . . it will be very difficult for other carriers to obtain slots to begin or expand U.S.-LHR service . . ." DOJ at 35.
- "without conditions to mitigate the harm, we would oppose the AA/BA transaction as we did three years ago." DOJ at 3.

DOJ's submission supports and validates Delta's position that the AA/BA alliance would produce major adverse competitive consequences, and that large-scale slot divestitures would need to be included as part of any remedial conditions. DOJ recommended remedial conditions to address two separate, yet equally important objectives:

First, to remedy the specific competitive harms in the overlap markets of New York-Heathrow and Boston-Heathrow, DOJ recommended that the Department require the divestiture of Heathrow slots and facilities sufficient to fund 9 daily flights (7 daily flights between New York and Heathrow and 2 daily flights between Boston and Heathrow). For these two markets, the DOJ recommends divestiture of 126 weekly slots and related facilities.

Second, for consumers to realize the public interest benefits of open skies – the fundamental predicate for granting antitrust immunity – DOJ recommends that the Department require the divestiture of sufficient slots and facilities to provide *de facto* open entry at London Heathrow. Thus, DOJ states that:

- "For Open Skies to provide significant consumer benefits, removal of the legal prohibitions of Bermuda II must be accompanied by meaningful access to Heathrow for airlines serving the U.S. Such access requires additional slots and related facilities, **over and above the divestitures needed to remedy competitive harm** created by the AA/BA transaction." DOJ at 5 (emphasis added).

- "To achieve *de facto* Open Skies, DOT must provide for slots and related facilities **in addition** to those needed to remedy competitive harm in the NYC and BOS markets." DOJ at 52 (emphasis added).

While DOJ did not specify the number of additional slots and facilities (over and above the 126 weekly slots needed to the two overlap markets) necessary to ensure *de facto* open skies, the record is compelling that the total number of divestitures needed today is, at minimum, equal to the 24 daily flights DOJ recommended in the previous case.[1] In the interim, the U.S.-Heathrow incumbents have continued to grow stronger, Heathrow slots and facilities have become even more congested, and the United/bmi alliance now takes bmi and its substantial Heathrow resources out of the running as a potential source of new entry, further increasing the slot concentrations of the two alliances and raising the added possibility of collective dominance.

Delta has demonstrated that slots sufficient to fund at least 36 new daily Heathrow flights would be needed to competitively counteract the Heathrow alliances. Without significant Heathrow slot and facility divestitures to permit such meaningful new competitive entry, the benefits of open skies would be completely illusory.

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[1] In recent press releases, American and British Airways have attempted to mischaracterize DOJ's comments. Contrary to the Joint Applicants' public statements, DOJ's filing did not state that only 126 weekly slots and related facility divestitures would cure the defects of the restricted Heathrow marketplace. Instead, DOJ stated that the divestiture of 126 weekly slots and related facilities is needed to remedy the competitive harm in the NYC and BOS markets alone, and that many more slots would be need to be divested to provide meaningful *de facto* access for consumers through access to competitive services at Heathrow.

A. Heathrow non-incumbents must be afforded access to slots to provide any meaningful consumer benefits under an "open skies" agreement ***and*** to compete with the alliance on overlap routes that will lose competition.

1. Divestiture Requirements To Ensure *De Facto* Open Skies.

The DOJ strongly urged the Department to remain true to its commitment of securing both *de jure* and *de facto* access for U.S. carriers at Heathrow airport as part of any "open skies" deal with the UK. The DOJ correctly observed that in order to find the alliance consistent with the public interest, the Department must do far more than merely alleviate the particular competitive maladies of the alliance on discrete city-pair routes – it must provide significant new entry opportunities, so that there will be *a net gain in consumer benefits.*

The DOJ warned that "because of physical constraints at LHR, even completely neutralizing the competitive harm from combining AA and BA would do little more than preserve and perhaps solidify the concentrated market structure that evolved under the Bermuda II Agreement." DOJ at 3. Such a result would render an open skies deal that does not include new entrant slot and facilities guarantees at Heathrow a hollow and meaningless achievement – and a major step backwards for competition and consumers. This is emphatically *not* what Congress had in mind when it authorized the Secretary to grant exemptions from the antitrust laws "to achieve important public interest benefits." 49 U.S.C. § 41309(b). Rather, as the Justice Department points out:

"For Open Skies to provide significant consumer benefits, removal of the legal

> prohibitions of Bermuda II must be accompanied by meaningful access to Heathrow for airlines serving the U.S. Such access requires additional slots and related facilities over and above the divestitures needed to cure the competitive harm created by the AA/BA transaction." DOJ at 5.

The DOJ did not elaborate on the specific number of slots and related facilities necessary to provide such meaningful access for Heathrow non-incumbents. However, in its prior comments in Docket OST-97-2058, the DOJ explained that enough slots and related facilities should be divested for the benefit of non-incumbents "to ensure access to LHR that would permit the level of service between LHR and the United States that would be expected in an open market." DOJ Comments, May 21, 1998, page 2. At minimum, each of the major Heathrow non-incumbents would need to offer multiple daily services from its primary hubs (along with, as here, direct nonstop-to-nonstop competition with the alliance on key overlap routes). *Id.* at 33, 39. Likewise, in its current comments, DOJ made it clear that the number of slots and facilities needed to ensure meaningful *de facto* Open Skies is "over and above" the slots and facilities necessary to fix the competitive harms in the overlap markets. DOJ Comments at 49.

Delta and Northwest have each provided exhibits and market analysis detailing the approximate number of slots (with related facilities) necessary to achieve meaningful access for the non-incumbents. That number is in the range of 420 to 504 weekly slots to

support between 30 and 36 new daily U.S.-London Heathrow flights.[2] *See, e.g*. DL-47-48. A divestiture of slots and facilities of this magnitude would be necessary to satisfy the DOJ's recommendation that the divestitures should permit the approximate number of competitive flights that would be expected in an open market, thus achieving *de facto* Open Skies.

2. Divestiture Requirements to Remedy Competitive Harms on AA/BA Overlap Routes.

In addition to the large pool of slots and related facilities that would be required to provide *de facto* open skies through meaningful Heathrow access, the DOJ expressed special concern about the need to make slots and facilities available for new entrants to remedy the specific competitive harm that would be caused the loss of competition between AA and BA on two important overlap routes: New York-Heathrow and Boston-Heathrow. DOJ recommends that the Department require divestiture of at least nine daily slot pairs and facilities for the two markets: seven daily round-trip slot pairs and facilities in the NYC-LHR market and two daily round-trip slot pairs and facilities in the BOS-LHR market to help alleviate the acute reduction in competition on these routes. DOJ at 50.

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[2] In order to provide effective network competition against the AA/BA alliance, Delta would need sufficient slots to operate at least three daily Heathrow nonstops from its Atlanta hub and two daily Heathrow nonstops from its Cincinnati hub. To remedy the specific competitive harms on the overlap routes identified by the Justice Department, Delta would need three or more daily flights on JFK-Heathrow and double-daily service on the BOS-LHR route.

The DOJ correctly determined that additional Heathrow services by competitors are needed from both New York and Boston to Heathrow, markets with a large base of business passengers. At New York, prior to September 11, American and British Airways offered 16 daily frequencies. The AA/BA combined flight offerings will require competitors to be able to offer multiple frequencies to be in a position to counter the alliance in that city pair. DOJ at 44.

The Justice Department also recommends that competitors be able to offer new Heathrow services from Boston in competition with the Joint Applicants. As highlighted in the DOJ's analysis, competitors need access to Heathrow, not Gatwick to have a competitive product from Boston. American's own experience in the Boston marketplace demonstrates that Gatwick is not an acceptable alternative for Heathrow, particularly for business travelers: "basically, all the passengers traveling on American['s Boston flight] [we]re choosing to go to Heathrow, not Gatwick. Not surprisingly, American exited the Boston-Gatwick route due to its poor profitability, but retained its Boston-Heathrow service." *Id.* at 20-21. The ability to offer Boston-Heathrow flights in competition with the four that are currently offered by AA and BA is important for Boston "business customers who value frequency." *Id*. at 31.

3. DOJ Analysis Confirms the Importance of Timing - Any AA/BA Codesharing or Antitrust Immunized Activities Should Be Delayed Until New Competitive Services Are in the U.S.-Heathrow Marketplace.

There is serious question as to whether any remedies could be imposed sufficient to overcome the adverse competitive impacts of the alliance. However, if the Department is able to obtain such remedies and grant approval to the alliance in connection with an open skies agreement, the DOJ correctly identified timing as a critical issue, and urged the Department to "limit immunity . . . until other carriers are able to actually begin operating at LHR to offset that harm." DOJ at 6. Delta agrees with the DOJ that timing is critical, and that Delta and other new entrants should have full competitive access to Heathrow on *Day One* the alliance is allowed to conduct *any* code-sharing or joint immunized activities at Heathrow. Otherwise, the alliance will be able to advance its already enormous lead in locking up key frequent business travelers and corporate customers. Even without immunity, the alliance has been able to capture increased traffic by pooling frequent flyer programs and through other cooperative efforts.

As acknowledged by the DOJ, BAA, ACL, and even the applicants themselves, slot and facility growth at Heathrow is slim or non-existent. Virtually all slots and facilities available to would-be new entrants would need to come from the applicants. Since the Joint Applicants will no doubt immediately begin rationalizing services and aligning their operations, the Department should announce the required number of slot and facility divestitures so that the Joint Applicants and new entrants can make the required implementation plans before the alliance is allowed to operate. It also goes without saying that any carrier selection and other governmental or slot coordinator

approvals would need to be completed and in place prior to the effectiveness of any immunity.

B. The Justice Department's Comments Refute the Applicants' Erroneous Claims About the Heathrow Marketplace

The DOJ convincingly debunked a number of the specious arguments and "studies" put forward by the applicants in support of their alliance.

1. Heathrow is a separate relevant market.

The evidence is overwhelming that passengers – particularly business passengers – vastly prefer Heathrow service over Gatwick. The Justice Department's comments provide further vivid illustration evidence of what every market participant already knows to be true. In several case studies, the DOJ shows that American, Virgin and British Airways were each forced to withdraw Gatwick service – or move them to Heathrow – in the face of dramatically better operating results experienced by "competing" Heathrow flights operating from the same U.S. gateway. This was true for a number of failed Gatwick service attempts including Boston, New York and Miami. *See*, DOJ Comments at 20-22.

2. Heathrow slots are no more available now than they were three years ago.

The DOJ confirmed its prior findings that there are no slots available to permit the introduction of competitive U.S.-Heathrow services, and that "entry conditions have not improved in the intervening three years." DOJ at 35. The recent comments of Virgin Atlantic – the only non-applicant U.S.-Heathrow operator of any significance -- are also

instructive on this important point. Virgin dispels the notion that "new entrant airlines will be able to enter the U.S.-Heathrow markets. . . . Virgin takes particular offense at these fabrications. There are no suitable slots available at Heathrow Airport. None." Virgin at 4 (emphasis added).

As the DOJ's analysis shows, the so-called Heathrow new entrant slots have been completely ineffective in terms of enhancing competition against the major slot holders such as BA. DOJ at 36-37.

The DOJ correctly notes that "slots sales are prohibited under the European Union rules" and that the gray market for slot trading does not provide any realistic hope for new entrants to secure commercially viable transatlantic slots. *Id.* at 37. This is illustrated by the fact that "Virgin, which has been actively trying to obtain slots to increase its U.S.-LHR service, has succeeded in getting slots in the secondary market for only three daily frequencies since 1996." *Id.* at 38.

3. Alliance partners are not a viable source of Heathrow slots.

The DOJ confirms that European carriers would not be willing to part with their own essential Heathrow slots to provide U.S. alliance partners with slots for U.S.-Heathrow service. The operating economics of immunized alliance partnerships are far from the point where one partner is willing to sacrifice its own vital services for the benefit of the other. *Id.* at 40. Thus, "London is a top business destination from almost every city in the world and competitive service is critical to the partner airlines.

Expectations that, for example, Air France would reduce LHR-Paris service to provide Delta with slots therefore seems unrealistic." *Id.*

4. Heathrow Airport Facilities Are Also Constrained.

Heathrow is completely saturated in terms of the essential terminal facilities, widebody gates and parking stands necessary to accommodate new competitive services during the transatlantic operating window. As noted by the DOJ, "there is little chance that additional capacity will become available in the short run." DOJ at 41- 42. Thus, airport facilities access guarantees, as well as slots, must be included as part of any remedial conditions in order to assure *de facto* new entry and competition at Heathrow.

C. Conclusion.

The Comments of the Justice Department underscore the critical importance of London Heathrow Airport and serious potential for harm to consumers that would be caused by granting antitrust immunity to the primary U.S.-Heathrow competitors. Substantial slot and facility divestitures would be required *both* to offset the particular competitive harms caused by the alliance *and* to secure the purported public interest benefits of open skies by providing *de facto* open access for new entrants at Heathrow.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that a copy of the foregoing Reply has been served this 20th day of December 2001, upon each of the following persons in accordance with the Department's rules.

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